Supreme Court, U.S.
FILED
NOV. 6 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1910

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

BUSINESS ELECTRONICS CORPORATION,
Petitioner,

v.

SHARP ELECTRONICS CORPORATION,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF FOR THE CONSUMER ELECTRONICS GROUP OF THE ELECTRONIC INDUSTRIES ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF AFFIRMANCE

GARY J. SHAPIRO
Staff Vice President
Government and Legal Affairs
The Consumer Electronics Group
of the Electronic Industries
Association
2001 Eye Street, N.W.
Washington, D.C. 20006
(202) 457-4919
Counsel for Amicus Curiae

November 6, 1987

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether it should be *per se* illegal for a manufacturer to agree with a full-service distributor to terminate another distributor who does not provide services as a means of preserving the viability of the full-service distrbutor and assuring that vital services associated with the product will continue to be offered.

TABLE OF CONTENTS

	Page
INTEREST OF AMICUS CURIAE	1
STATEMENT	2
SUMMARY OF ARGUMENT	4
ARGUMENT	
A. Manufacturers Must Be Able to Set Minimum Non-Price Standards For The Distribution of Their Product	7
B. The Rule Applied By The Court Of Appeals Sets The Proper Balance Between Allowing Manufacturers Control Of The Distribution Of Their Product Without Allowing Control Of The Price Of The Product	10
CONCLUSION	13

TABLE OF AUTHORITIES

Cases:

Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984) ---- 4, 6, 9, 10
Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) ---- 5, 7, 8
Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164 (3d Cir. 1979) ---- 6, 11, 12
Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742 (7th Cir. 1982) ---- 12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 85-1910

BUSINESS ELECTRONICS CORPORATION,
Petitioner,

v.

SHARP ELECTRONICS CORPORATION,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF FOR THE CONSUMER ELECTRONICS GROUP OF THE ELECTRONIC INDUSTRIES ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF AFFIRMANCE

INTEREST OF AMICUS CURIAE

The Consumer Electronics Group of the Electronics Industries Association ("EIA/CEG") a trade association that represents most manufacturers of audio, video and home information equipment, files this amicus curiae brief in support of Respondent.[1] The manufacturers repre-

[1] Pursuant to Rule 36.1 of this Court, consent to the filing of this brief has been granted by both parties. Their consents have been filed with the Clerk.

sented by EIA/CEG have networks of distributors and retail dealers [2] who, through their sales efforts, determine a product's market penetration and shape consumers' views of a manufacturer.

With more than 50 brands of televisions and 50 brands of VCRs being sold, manufacturers need every competitive tool available to fight for market share in an intensely competitive marketplace. Imposition of a *per se* rule affecting distribution of a product restricts a manufacturer from a range of options—many of which enhance efficiency. Because this Court's decision in the present case will have a substantial impact on whether manufacturer's can take action imposing non-price vertical restraints which are often desirable in distributing products, it is of substantial concern to the *amicus curiae*.[3]

STATEMENT

1. In 1973, Sharp Electronics Corporation ("Sharp") terminated one of two Houston dealers carrying its electronic calculators, Business Electronics Corporation ("BEC"). BEC had been appointed the sole Houston distributor of Sharp calculators in 1968. Tr. 58-59. BEC, however, proved to be ineffective at stimulating sales. By 1972, it had fallen well behind the sales quotas Sharp had set. Defendant's Trial Exhibit No. 26. Sharp therefore decided to terminate BEC's dealership, Tr. 827-830, 700, and agreed to replace BEC with Gilbert Hartwell, Tr. 321-324. Hartwell was a full-service dealer who offered

[2] The terms "distributor(s)" and "dealer(s)" are used interchangeably through this brief as some manufacturers use a two-step distribution process—going through distributors, while others go directly to retail dealers.

[3] This *amicus curiae* brief represents the consensus view of the diverse membership of EIA/CEG. It should not be construed as having been submitted on behalf of or representing the views of any individual company.

a range of costly presale advertising, information and demonstration services. Tr. 343-344, 1031, 1102-1103. Sharp believed that in a market in which there was fierce interbrand competition, Tr. 931, Hartwell would be more effective than BEC in familiarizing consumers with Sharp's new, complex and expensive electronic calculators.

Though Hartwell had been assured he would have the exclusive Houston dealership in Sharp calculators, Tr. 322-324, there was some delay in terminating BEC. Tr. 1307-1308. With Hartwell's full-service dealership now operating in the same market, BEC took the opportunity to free-ride on Hartwell's services. Dispensing even with the few services that it had previously offered, BEC began to divert customers who had been persuaded to buy Sharp calculators through Hartwell's efforts, simply by distributing fliers offering the calculators at lower prices —prices Hartwell could not match if he was to cover the cost of providing the services necessary to educate customers about the merits of Sharp products. Tr. 110; 279-280; 283-284; 343-344; 346-348.

Hartwell complained about BEC's free-riding to Sharp. Tr. 249-280. He complained not about BEC's discounted prices as such, but about BEC's diversion of buyers: "We did all the legwork, all the selling and one little piece of flier came in and (the customer was) ready to buy the same product from (BEC)." Tr. 347-348. Eventually, in June 1973 Hartwell told Sharp that he would cease to sell Sharp calculators unless BEC was terminated within 30 days. Tr. 367-372; 420; 441. Sharp responded by terminating BEC. Tr. 371-374; 774-775; 867; 1309.

2. BEC then brought suit, alleging that Sharp's termination of BEC was pursuant to a price-fixing agreement illegal under the Sherman Act. The district court instructed the jury that it should find Sharp liable if it had agreed with Hartwell to terminate BEC because of BEC's

price cutting. J.A. 18. The jury returned a verdict for $600,000 in favor of BEC.

On appeal, the Fifth Circuit reversed, holding that the termination of a price cutter is not *per se* illegal unless it occurs as part of an agreement with a dealer to "set its prices at some level." Pet. App. 14a. In other words, "(t)he distributor cannot retain complete freedom to set whatever price it chooses." *Ibid.* The Court stated that this rule is necessary if manufacturers are to have flexibility to structure and adjust their distribution networks to achieve maximum efficiency. Citing this Court's concern in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), that "legitimate conduct on the part of the manufacturers and distributors would not be penalized due to the ambiguity of . . . legal rule(s)," Pet. App. 11a, the Fifth Circuit upheld the freedom of manufacturers to terminate dealers in order to further legitimate nonprice goals such as preventing free-riding on presale services. The Fifth Circuit rejected alternative approaches that require a jury to determine whether a manufacturer's motives in terminating a price cutter are to reduce price competition or to protect distributors from free-riders, stating that a rule under which a manufacturer's "antitrust liability turned solely on a jury's guess as to the manufacturer's motivation" would deter legitimate manufacturer action. Pet. App. 12a.

SUMMARY OF ARGUMENT

A.

A manufacturer which has researched a market, identified a demand and developed a product to meet that demand has an important interest in structuring the distribution network through which its product will be marketed, and in ensuring that dealers in that network use the most appropriate and effective methods available to market the product. For many products, marketing is most effective when retailers offer prospective purchasers

a high level of pre-sale and post-sale services, educating the customer about the product, demonstrating its capabilities, and exploring with the customer whether the product meets his or her needs. *See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 54-56 (1977). This sales method is particularly important for products new to the market and unfamiliar to consumers, and in general for any complex product where consumer satisfaction depends on understanding the product before making a purchase. The provision of pre-sale and other services increases sales, enhances consumer satisfaction and creates manufacturer goodwill. Manufacturers often require that their distributors and dealers provide these services.

Pre-sale and other services are often costly for distributors and dealers to provide. Free-riders may rely on full-service dealers to educate customers and persuade them to buy a product, and then divert the sale from the full-service dealer by offering the product at a lower price. Free-riders can charge less because they do not need to include in their price any amount covering the services that produced the sale—services that were provided by another dealer. In a market where free-riders operate, costly dealer-provided services soon disappear, as dealers are forced to drop them in order to compete on price. To ensure effective marketing of its products, a manufacturer must be able to exercise a reasonable degree of control over the methods used by its distributors. In particular, if it is to ensure that dealers offer the most effective mix of services, a manufacturer must be able to prevent free-riders from disrupting its distribution system.

B.

The fact is that virtually every vertical restraint affects product price. Servicing requirements, sales training, product promotion, all contribute to dealer costs and thus product price. A manufacturer should be able to impose

dealer requirements in any event, even though they indirectly affect price.

A manufacturer is hampered in dealing with free-riders however, by ambiguous legal rules that leave it uncertain of the legality of proposed courses of action. Manufacturers require unambiguous legal rules that establish clearly what agreements with dealers are illegal *per se* under the Sherman Act. Otherwise, the threat of treble-damage liability will deter manufacturers from action that would make for more effective marketing—and for more vigorous competition in the marketplace.

The rule applied by the Third Circuit in *Cernuto, Inc. v. United Cabinet Corp.*, 595 F.2d 164 (3d Cir. 1979), fails to provide manufacturers with meaningful guidance on the scope of *per se* illegality under the Sherman Act. Under the *Cernuto* rule, a jury may conclude that a manufacturer entered into an illegal price-fixing agreement if it finds that the agreement was motivated by a desire to restrain prices. Many perfectly legitimate nonprice agreements have an indirect impact on prices, and a rule under which treble-damage liability depends on a jury's ability to tell whether a manufacturer's action was motivated by a price effect or by a legitimate non-price objective is bound to chill legitimate manufacturer action.

The rule applied by the Court of Appeals in this case, on the other hand, follows in the tradition of *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), in reducing legal uncertainty concerning Sherman Act liability. The Fifth Circuit held that only agreements requiring a dealer to "set its prices at some level"—that is, agreements restraining a dealer's price flexibility in some way—are *per se* illegal. Pet. App. 14a. Under this rule, manufacturers have a clear guideline to follow in structuring their relations with distributors, and can react to the entry of free-riders into the market.

In short, agreements to set price are and should be *per se* illegal. Agreements which merely affect prices should be evaluated on their competitive effects.

ARGUMENT

A. Manufacturers Must Be Able to Set Minimum Non-Price Standards For The Distribution of Their Product

The rational development of legal rules to implement the Sherman Act prohibition on agreements in restraint of trade depends on an understanding of business realities. A rational definition of vertical price-fixing agreements that are illegal *per se* under the Act depends, in particular, on an understanding of the manufacturer/dealer relationship, and of the manufacturer's need to shape the way in which dealers market its products.

Most manufacturers of consumer products must rely on a network of independent distributors to bring their products to the public. Experience has shown that the manner in which distributors carry out this task has a great impact on consumer perceptions of the manufacturer's products, on the sales levels those products achieve, and on manufacturer goodwill. Consumer goods suppliers know that sales potential is less important to marketplace success than the sales efforts of independent distributors.

The type of distribution network that will maximize a product's market penetration naturally varies from product to product. Similarly, the sales methods that will be most effective vary with the nature of the product and the market-segment at which it is aimed. The manufacturer, who has studied the market, identified a demand and developed a product to satisfy that demand is in the best position to know what sort of distribution network and what sort of sales methods will maximize the impact of its product in the marketplace.

A manufacturer generally has a number of policies regarding dealer promotion of its products. For some products, effective marketing requires that retailers provide consumers with a high level of presale service. *See Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54-56 (1977). A manufacturer that has developed a new

type of product may require retailers to provide potential customers with information about the product's function and capabilities, in order to educate consumers. Or a manufacturer that believes its product has significant advantages over its competitors may require the retailer to incur the expense necessary to train a staff which can explain and demonstrate those advantages.

A simple example illustrates the great importance of presale services. With the rapid development of video and audio technology, VCRs and compact disc players are manufactured with a wide range of features. Consumers may not understand the model differences unless the retailer explains and demonstrates those differences. For VCRs, the seller must explain to consumers the differences between machines with two or four heads, the effect of various kinds of circuitry, the operation of programming or editing features, and the various formats available. Only then can the consumer make an informed purchasing decision, and only then can a manufacturer be sure that its VCR has been properly understood and evaluated by the prospective purchaser, and weighed on its merits against its competitors.

There are many other ways in which a retailer's efforts affect a product's success in the market place. A manufacturer may wish to ensure that retailers carry a broad line of products, maintain sufficient stock to be able to meet orders quickly, provide an attractive and spacious shopping environment, offer prompt delivery and installation, or maintain facilities to repair products the retailer has sold. All or some combination of these retailer services may increase a product's sales, enhance consumer satisfaction, and invigorate competition. *See Sylvania*, *supra*, 433 U.S. at 54-55. It is vital, therefore, that manufacturers be able to supervise the operations of dealers, and control how a product is presented to potential purchasers.

Innovative manufacturers require flexibility. When certain activity is labeled *per se* illegal—manufacturers are by definition precluded from even explaining how their actions may improve efficiency and competition.

A manufacturer concerned with the integrity and effectiveness of its distribution network must be able to prevent disruption of that network by free-riding retailers. The sales methods that manufacturers desire retailers to use often involve significant initial investment and recurring expense for the retailers which must be recovered in the prices retailers charge their customers. Continued provision of necessary services is endangered if some retailers free-ride on services others have provided. This occurs when a full-service retailer informs the customer about a product and persuades the customer that the product fits his or her needs, but then loses the sale to a retailer who is able to offer the product for a lower price because it offers few or no services. Free-riders divert customers from retailers whose services—provided at substantial expense—have in effect "made the sale." Naturally enough, it is the full-service dealers who are a manufacturer's best source of information about the arrival of free-riders in the area. As the *Monsanto* Court recognizes, complaints from full-service dealers are a common element in business life.

Full-service dealers cannot afford to subsidize free-riders by offering costly services. Thus, in a market where free-riders operate, retailer-provided services can rapidly disappear. This can seriously injure a manufacturer dependent on retailer services to market its product effectively. Such manufacturers must be able to protect their full-service retailers from free-riders in order to keep their distribution systems efficient and to compete vigorously with rival manufacturers.

B. The Rule Applied By The Court Of Appeals Sets The Proper Balance Between Allowing Manufacturers Control Of The Distribution Of Their Product Without Allowing Control Of The Price Of The Product

For the reasons just discussed, a manufacturer must be able to exercise reasonable supervision over its distribution system to ensure efficient marketing of its products. And it is of vital importance that a manufacturer attempting to supervise its distribution network have the guidance of clear legal rules. Without bright-line rules establishing which dealer agreements are illegal, manufacturers may be reluctant to terminate inefficient dealers in ways which would enhance efficiency and strengthen competition. Manufacturers are deterred from making such adjustments by the threat of expensive lawsuits alleging an illegal agreement to fix prices. Without clear rules defining price-fixing agreements, the outcome of such lawsuits is difficult to predict and they may well result in treble-damage liability.

This Court is well-aware of the need for clear legal rules in this area, having recently stated that "it is of considerable importance that . . . concerted action on nonprice restrictions . . . be distinguished from price-fixing agreements, since under present law the latter are subject to *per se* treatment and treble damages." *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763 (1984). The amicus wishes to stress, however, that the harm caused by a lack of clear rules identifying *per se* illegal agreements does not stop with the unpredictable imposition of treble-damage liability. Rather, the harm extends to the perpetuation of inefficient sales practices, such as free-riding on another dealer's services, which disrupt distribution systems and dampen market competition.

In *Monsanto*, this Court acted to protect manufacturers from uncertainty created by the possibility that price-fixing agreements might be inferred from highly ambiguous evidence. In the present case, the Court has the opportunity to protect manufacturers from the uncertainty that follows from any definition of price-fixing that invites a jury to guess the manufacturer's motives in entering an agreement.

The rule applied by the Fifth Circuit in this case brings welcome and indeed essential certainty to the manufacturer-distributor relations, by making it clear that only agreements that restrict the dealer's price flexibility in some way are *per se* illegal. Pet. App. 14a. Under this definition, a manufacturers knows with certainty that agreements to protect dealers from free-riders and thereby achieve goals such as the continued provision of services to consumers will be treated by the courts under the rule of reason, and not under *per se* rules.

The Fifth Circuit properly rejected the definition of vertical price-fixing adopted by the Third Circuit in *Cernuto, Inc. v. United Cabinet Corp.*, 595 F.2d 164 (3d Cir. 1979). Under *Cernuto*, a manufacturer faces the prospect of treble-damage liability simply because an adjustment to distribution network has an indirect impact on price, even though the adjustment was undertaken in order to prevent free-riding on full-service dealers and even though it involves no agreement that restricts a dealer's flexibility in setting its prices. Such liability may be imposed if a jury decides that an overtly nonprice agreement having an indirect price impact was in fact *motivated* by a desire "to restrain price movements." *Id.* at 168-169. The *Cernuto* rule creates enormous uncertainty because "(a)ny vertical non-price restriction may affect resale prices," including any legitimate restriction. Pet. App. 9a. As a result, the rule leaves the manufacturer's fate dependent on a jury's ability accurately to psychoanalyze the manufacturer's motives to determine whether the inevitable price impact of an agreement was the agreement's purpose or merely its incidental consequence. As Judge Posner has accu-

rately noted, "(t)here is . . . a certain unreality in the careful parsing of motives that *Cernuto* seems to require." *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 744 (7th Cir. 1982).[4]

The chilling effect on manufacturers of such an amorphous psychological inquiry cannot be overestimated. The Fifth Circuit correctly stated the problem: "the manufacturer which desires to terminate a price cutter because of its free riding will be deterred from this legitimate action because it is indistinguishable, except perhaps to a mind reader, from what *Cernuto* prohibits, *i.e.*, termination of a price cutter because of its price cutting." Pet. App. 12a. As Judge Jones cogently remarked, "(s)emantic nuances are costly to businessmen in the real world," Pet. App. 22a—particularly, we would add, when these nuances are directed at juries.

What is costly to businessmen will be costly to consumers. The uncertainty generated by *Cernuto's* semantic nuances results in serious inefficiency costs to manufacturers attempting to organize and oversee the operation of an effective distribution system. These costs are of necessity passed on to the ultimate purchaser in the form

---

[4] Judge Posner continued (*ibid.*):

> "If a supplier wants his distributors to emphasize nonprice rather than price competition, which . . . is the usual reason why he would restrict his distribution, he will be hostile to price cutters because they will make it harder for his other distributors to recoup the expenditures that he wants them to make on presale services to consumers and on other forms of nonprice competition, and of course the undersold distributors will be equally or more hostile. The motive of supplier and distributors alike could thus be described as wanting to eliminate price cutters yet there would be no *per se* illegality so long as the supplier was not just knuckling under to the distributors' desire for less competition. It is difficult to see how a court could distinguish empirically between such a case and the pure antipathy to price competition envisaged by *Cernuto*."

of higher prices. Thus, it is the consumer—the intended beneficiary of the Sherman Act—who in the final analysis has most to gain from the certainty provided by the Fifth Circuit's rule in this case.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

GARY J. SHAPIRO
Staff Vice President
Government and Legal Affairs
The Consumer Electronics Group
of the Electronic Industries
Association
2001 Eye Street, N.W.
Washington, D.C. 20006
(202) 457-4919
Counsel for Amicus Curiae

Dated: November 6, 1987

APPENDIX A

ELECTRONIC INDUSTRIES ASSOCIATION
CONSUMER ELECTRONICS GROUP
MEMBERSHIP
OCTOBER, 1987

COMPANY
Allsop, Inc.
Ambico, Inc.
Ampex Corporation
AOC International
Arvin Electronics
Asti Nikko Technology Corp.
Atari Corporation
Audiovox Corp.
Audio Research Corp.
Audio Technica U.S., Inc.
Bang & Olufsen of America, Inc.
Barcus-Berry Electronics, Inc.
BASF Corp. Information Systems
Bib Audio/Video Products
Blaupunkt Div./Robt. Bosch Sales
Boston Acoustics, Inc.
Byte Resources Company
Canon U.S.A., Inc.
Canton
Casio, Inc.
Clarion Corp. of America
Cord Electronics Inc.
Curtis Mathes
Delco Electronics Corp.
Denon America, Inc.
Discovery Systems, Inc.
Dynascan Corp.
Eastman Kodak
Emerson Radio Corp./H.H. Scott

Epson America, Inc.
Finial Technology
Fisher Corporation
Fortel Corporation
Fox Marketing, Inc.
Fuji Photo Film USA, Inc.
GC Thorsen
General Electric Company
Goldstar Electronics International, Inc.
The David Hafler Company
Hitachi Sales Corp. of America
Home Information Systems
International Jensen
Jasco Products Co., Inc.
JBL, Inc./Harman Intl.
JVC Company of America
Kenwood Electronics
Kloss Video Corporation
Konica U.S.A., Inc.
Lebo Peerless Corporation
Madrigal, Ltd.
Magnepan, Inc.
Marantz Company, Inc.
Maxell Corporation
Memtek Products
Mitsubishi Electric Sales America, Inc.
Monster Cable Products, Inc.
Mura Corp.
N.A.P. Consumer Electronics Corp.
NEC Home Electronics (U.S.A.) Inc.
OKI America, Inc.
Ortofon, Inc.
Panasonic Company
Pfanstiehl
Pioneer Electronics (USA), Inc.
Polaroid Corporation
Polk Audio, Inc.
Quasar Company

Rabbit Systems, Inc.
Recoton Corporation
Royal Sound Company, Inc.
Samsung Electronics America, Inc.
Sansui Electronics Corp.
Sanyo Manufacturing Company
Scosche Industries
Sega of America, Inc.
Sharp Electronics Corp.
Shure Brothers, Inc.
Sima Products Corporation
Sony Corporation of America
Studer Revox America, Inc.
Tandberg of America, Inc.
Tandy Corporation
TDK Electronics Corp.
TEAC Corporation of America
Telequest, Inc.
3M Company
Toshiba America, Inc.
Triad Design, Inc.
Videonics Incorporated
Wells-Gardner Electronics Corp.
Xantech Corporation
Yamaha Electronics Corp. U.S.A.